raising this allegation in the proper context.[500]

173. Based on the foregoing, we conclude that we should require independent LECs to provide in-region, interstate, interexchange services through a separate affiliate that satisfies the Fifth Report and Order separation requirements. We further conclude that, in light of our finding that independent LECs do not have the power to raise and sustain interexchange rates above competitive levels, it would be inconsistent with our analysis to allow independent LECs to choose whether to be regulated as a dominant carrier when providing in-region, interstate, domestic interexchange services. We are aware, however, of three independent LECs, Union Telephone Company (of Wyoming) (Union), GTE Hawaiian Tel., and MTC, that currently provide interexchange services on an integrated basis subject to dominant carrier regulation. We recognize that the costs of complying with the Fifth Report and Order separation requirements faced by a going concern could be greater than the costs of complying with these requirements for independent LECs that are currently providing these services on a separated basis. Accordingly, Union, GTE Hawaiian Tel., and MTC shall have one year from the date of release of this Order to comply with the Fifth Report and Order separation requirements.[501] Until that time, the Commission will continue to regulate these independent LECs as dominant carriers. The record in this proceeding does not reflect special circumstances necessary for a waiver of one or more of these requirements. To the extent that special circumstances exist, however, independent LECs may petition us to establish the necessity of a waiver of the Fifth Report and Order requirements.

174. Because section 3(40) of the Communications Act defines a state to include the "Territories and possessions" of the United States, CNMI is a state for purposes of domestic telecommunications regulation.[502] In our Rate Integration Order, we stated that, in making the section 254(g) of the Communications Act rate integration provision applicable to interstate interexchange services provided between the "states," as defined by section 153(40)

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[500] We note that on July 24, 1996, MCI filed an informal complaint with the Commission against SNET regarding PIC-freeze disputes. Letter from MCI to John Muleta, Chief, Enforcement Division, Common Carrier Bureau (July 24, 1996), Informal Complaint No. IC96-09734 (requesting the Commission to conclude that SNET's solicitations authorizing SNET to protect long distance customers from being switched without express consent violate section 201(b) and 251 of the 1996 Act.) In addition, on September 27, 1996, AT&T filed a letter with the Enforcement Division requesting the Commission to establish procedures under which neutral third parties administer PIC protection. Letter from AT&T to John Muleta, Chief, Enforcement Division, Common Carrier Bureau (Sept. 27, 1996).

[501] This does not affect the requirement that these providers integrate rates across their affiliates. *See* Rate Integration Order, 11 FCC Rcd 9598 (¶ 69).

[502] 47 U.S.C. § 153(40).

of the Communications Act, Congress made rate integration applicable to interexchange services provided between the contiguous forty-eight states and U.S. possessions and territories, including CNMI.[503] In the Rate Integration Order, we required providers of interexchange services between the Northern Mariana Islands and the contiguous forty-eight states to do so on an integrated basis with other interexchange services they provide by August 1, 1997. MTC and all other carriers providing off-island services between CNMI and other states are required to comply with these requirements. We find no basis in the record of this proceeding to amend these requirements. We further note that, although our Rate Integration Order does not require providers of interexchange service to integrate services offered to subscribers in the Commonwealth until August 1, 1997,[504] this does not affect our finding that, if MTC continues to provide in-region, interstate, interexchange service directly, it must continue to comply with our dominant carrier requirements prior to that date.

175. We find no basis on the record in this proceeding to impose additional requirements on MTC's provision of in-region, interstate, domestic, interexchange service, beyond those applied in this Order. To the extent that CNMI or any other petitioner can demonstrate that MTC has violated our rules, we encourage parties to file a petition asking the Commission to impose additional requirements through a petition for declaratory ruling or a complaint filed pursuant to section 208 of the Communications Act.

2. Application of Fifth Report and Order Separation Requirements to Incumbent Independent LECs

a. Background

176. In the Non-Accounting Safeguards NPRM, we tentatively concluded that, because an independent LEC's control of local exchange and exchange access facilities is our primary rationale for imposing a separate affiliate requirement on independent LECs, we should limit application of any separation requirements that we adopt in this proceeding to incumbent LECs that control local exchange and exchange access facilities.[505] For purposes of determining which independent LECs are "incumbent," we proposed to use the definition of "incumbent local exchange carrier" contained in section 251(h) of the Communications

[503] Rate Integration Order, 11 FCC Rcd at 9596, ¶ 66.

[504] Rate Integration Order, 11 FCC Rcd at 9596, ¶ 68.

[505] Non-Accounting Safeguards NPRM at ¶ 153.

Act.[506] Section 251(h) provides that a LEC is an incumbent LEC, with respect to a particular area, if: (1) the LEC provided telephone exchange service in that area on the date of enactment of the 1996 Act (February 8, 1996), and (2) the LEC was deemed to be a member of NECA on the date of enactment or the LEC became a successor or assign of a NECA member after the date of enactment.[507]

b. Comments

177. AT&T agrees with the tentative conclusion that only those independent LECs that control local exchange or exchange access facilities should be subject to the requirements adopted in this proceeding and that the Commission should rely on the definition of "incumbent local exchange carrier" provided in 47 U.S.C. § 251(h).[508]

178. NTCA, on the other hand, contends that the Commission should treat new entrants no differently than it treats small incumbent LECs because new LEC entrants that provide in-region interexchange services are free to, and have in fact, built or acquired control of local exchange access facilities.[509]

c. Discussion

179. We adopt our tentative conclusion that the Fifth Report and Order separation requirements should be imposed only on incumbent independent LECs that control local exchange and exchange access facilities. We believe this conclusion is consistent with the 1996 Act, which provides different regulatory treatment for incumbent and non-incumbent LECs.[510] This different treatment generally imposes fewer regulatory requirements on non-incumbent LECs, which we believe indicates Congress's view that such carriers are unable, at this time, to affect competition adversely, and therefore, are unable to generally harm consumers through unreasonable rates. We also believe that it would be premature to impose such regulation on competitive LECs when they possess little, if any, market power in the local exchange at this time. By limiting application of the separation requirements to incumbent independent LECs that control local exchange and exchange access facilities, we

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[506] Id.

[507] 47 U.S.C. § 251(h)(1). Section 251(h)(2) also allows the Commission to provide, by rule, for the treatment of a LEC or category of LECs as incumbent in particular circumstances. 47 U.S.C. § 251(h)(2).

[508] AT&T Aug. 29, 1996 Comments at 11.

[509] NTCA Aug. 29, 1996 Comments at 3.

[510] See, e.g., 47 U.S.C. § 251(c) (imposing additional obligations on incumbent local exchange carriers).

avoid imposing unnecessary regulation on new entrants in the local exchange market, such as neighboring LECs, interexchange carriers, cable television companies, and commercial mobile radio service providers, some of which may be small entities, thus facilitating market entry and the development of competition in the in-region, interstate, domestic, interexchange market..

3. Application of Fifth Report and Order Separation Requirements to Small or Rural Incumbent Independent LECs

a. Background

180. In the Non-Accounting Safeguards NPRM, we sought comment on whether there is some minimum size of independent LECs below which the separation requirements should not apply. We noted that, in principle, the size of a LEC will not affect its incentives to improperly allocate costs between its monopoly services and its competitive services, but that for small or rural independent LECs, the benefits to ratepayers of a separate affiliate requirement may be less than the costs imposed by such a requirement.

b. Comments

181. Several commenters contend that we should exempt certain small or rural independent LECs (e.g., non-Class A LECs or LECs serving less than two percent of the nation's access lines) from any separation requirements that are retained,[511] because the costs of imposing the separations requirements on small carriers may outweigh the likely benefits.[512] Several commenters argue that small incumbent LECs lack the market power to engage in anticompetitive conduct that is harmful to their interexchange rivals.[513] Sprint argues that its local operations have little ability and incentive to engage in anticompetitive

[511] SNET Aug. 29, 1996 Comments at 31-34; AT&T Aug. 29, 1996 Comments at 11-12; NTCA Aug. 29, 1996 Comments at 4. NTCA argues that if the Commission does not completely eliminate the separation requirements, we should, at a minimum, exempt rural telecommunications companies as defined in the 1996 Act. Id.

[512] NTCA Aug. 29, 1996 Comments at 4; SNET Aug. 29, 1996 Comments at 31-32. SNET, the largest independent LEC in this group, notes that it would be unable to force its in-region competitors to raise their interstate service prices by more than two-tenths of one percent under worst case assumptions. SNET Aug. 29, 1996 Comments at 33 and Attachment B.

[513] See NTCA Aug. 29, 1996 Comments at 3-4; Sprint Aug. 29, 1996 Comments at 3-4; Independent Coalition Sept. 13, 1996 Reply at 4-5.

conduct, since its service territories are widely dispersed and largely rural.[514]

182. GTE and Bell Atlantic argue that there is no economic basis for exempting small or rural independent LECs from the separation requirements imposed in this Order, especially given the increasing competition in local exchange and exchange access markets throughout the country.[515] GTE argues that all independent LECs, small and large, generally serve areas that are less densely populated than BOC service areas, have fewer access lines per switch on average, and provide relatively small volumes of interexchange traffic that originates and terminates in their region.[516]

c. Discussion

183. We conclude that we should not exempt any independent LECs from the Fifth Report and Order requirements based on their size or rural service territory because neither a carrier's size nor the geographic characteristics of its service area will affect its incentives or ability to improperly allocate costs or discriminate against rival interexchange carriers. Commenters favoring such an exemption provide no persuasive evidence that small or rural independent LECs that are not currently providing in-region interexchange service on an integrated basis subject to dominant carrier regulation would be adversely affected by continuation of the Fifth Report and Order separation requirements or that the safeguards are unnecessary for such carriers.[517] Accordingly, we will continue to apply the Fifth Report and Order separation requirements to all independent LECs, regardless of size.[518] Finally, we note that, although NTCA argues that the separation requirements may cause small companies to lose benefits in the form of name recognition and good will, the Fifth Report and Order requirements do not preclude an independent LEC from taking advantage of its good will by providing interexchange services under the same or a similar name.

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[514] See Sprint Aug. 29, 1996 Comments at 4-5.

[515] Bell Atlantic Sept. 13, 1996 Reply at 3 (arguing that there is no need for dominant regulation and that separation requirements should be minimized); GTE Sept. 13, 1996 Reply at 13.

[516] GTE Sept. 13, 1996 Reply at 14.

[517] Although suggested by several commenters, a rule that exempted all LECs with less than 2 percent of the nation's access lines would essentially eviscerate our regulation of independent LECs because it would exempt all 1100 independent LECs except the GTE companies (approximately 12 percent) and the Sprint/United companies (approximately 4 percent). Industry Analysis Division, Statistics of Communications Common Carriers 1996/96, (Com. Car. Bur. Dec. 1996), Tables 1.1, 2.3, and 2.10.

[518] As previously noted, an independent LEC may seek a waiver of the Fifth Report and Order requirements on the basis of special circumstances. See supra ¶ 173. We note, however, that a petitioner will face a heavy burden in demonstrating the need for such a waiver.

4. Classification of Independent LECs' Provision of In-Region, International Services

a. Background

184. In the Non-Accounting Safeguards NPRM we tentatively concluded that we should apply the same regulatory treatment to an independent LEC's provision of international services originating within its local service area as we adopt for independent LEC provision of interstate, domestic, interexchange services originating within its local service area.[519]

b. Comments

185. Most commenters support our proposal to apply the same regulatory treatment that we adopt for an independent LEC's provision of in-region interstate, domestic, interexchange services to an independent LEC's provision of in-region international services.[520] GTE argues that the Commission should not impose the Fifth Report and Order requirements on independent LECs providing either in-region domestic or international interexchange services because independent LECs do not have market power in the provision of domestic or international in-region interexchange services. GTE notes that it, and some other carriers, may be subject to dominant classification on particular routes pursuant to the Foreign Carrier Entry Order due to foreign carrier affiliations.[521]

186. MCI, on the other hand, argues that the Commission should generally apply the same regulatory treatment to independent LECs' provision of in-region, international services, but impose additional requirements where the LEC has a foreign affiliation or other commercial relationship with a foreign carrier.[522] MCI urges the Commission, at a minimum, to impose on the independent LECs in such circumstances the same safeguards that it imposed on MCI in the Order approving British Telecom's (BT's) initial 20 percent investment in MCI.[523]

187. In addition, CNMI asks the Commission to clarify that MTC is a dominant

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[519] Non-Accounting Safeguards NPRM at ¶160.

[520] See, e.g., CNMI Aug. 15, 1996 Comments at 11-12; Excel Aug. 15, 1996 Comments at 10.

[521] GTE Aug. 29, 1996 Comments at 40.

[522] MCI Aug. 29, 1996 Comments at 8 (citing MCI Aug. 15, 1996 Comments at 68-71).

[523] Id. See Order on MCI - BT Joint Petition, 9 FCC Rcd 3960.

carrier under the terms of the International Competitive Carrier Order.[524] CNMI states that in the International Competitive Carrier Order, the Commission ruled that MTC's parent company, GTE Hawaii, and similarly situated carriers were dominant. CNMI claims, however, that MTC was not covered by these policies when the Commission issued this Order because CNMI did not become a U.S. commonwealth until November 3, 1986.[525] CNMI asserts that, now that MTC is a domestic carrier with significant market power and a lack of effective competition in exchange and exchange access markets, the Commission should declare MTC dominant in its provision of in-region, interstate, international, interexchange service.[526] GTE replies that imposing dominant regulation on MTC's provision of in-region, interstate, international, interexchange service now, when MTC has operated as non-dominant for years,[527] would be contrary to the deregulatory goals of the 1996 Act.[528] In any case, GTE asserts that independent LEC international and domestic interexchange services should be regulated in the same manner and that independent LECs have no market power in the international service market. GTE further claims that MTC's exchange access service in the Northern Mariana Islands cannot give it market power in the international services market.[529]

c. Discussion

188. We confirm our tentative conclusion that we should adopt the same rules in this proceeding for an independent LEC's provision of in-region, international, interexchange services as we adopt for its provision of in-region, interstate, domestic, interexchange services. As discussed above with regard to BOC provision of in-region, international services, the relevant issue, with respect to both domestic interexchange and international services, is whether an independent LEC can exercise its market power in local exchange and

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[524] CNMI Aug. 15, 1996 Comments at 9-10(citing International Competitive Carrier Policies, CC Docket No. 85-107, Report and Order, 1022 FCC 2d 812 (1985) (International Competitive Carrier Order)).

[525] CNMI Aug. 15, 1996 Comments at 10. CNMI states that prior to November 3, 1986, the Commonwealth was part of the United Nations Trust Territory of the Pacific Islands and was apparently considered a foreign point. Id.

[526] CNMI Aug. 15, 1996 Comments at 10.

[527] GTE refers to two Commission decisions wherein the Commission classified GTE Hawaiian Tel and others as dominant in the provision of IMTS service, but did not include MTC in that classification. GTE states that the Commission has not disturbed these rulings, despite reexamining international dominance issues on numerous occasions. GTE Sept. 13, 1996 Reply at 17 (citing International Competitive Carrier Order).

[528] GTE Sept. 13, 1996 Reply at 17.

[529] GTE Sept. 13, 1996 Reply at 18.

exchange access services to raise and sustain prices of interexchange or international services above competitive levels by restricting its own output.[530] We find no practical distinctions between an independent LEC's ability and incentive to use its control over bottleneck facilities in the provision of local exchange and exchange access services to improperly allocate costs, unreasonably discriminate against, or otherwise engage in anticompetitive conduct against unaffiliated domestic interexchange competitors as opposed to international services competitors.

189. In light of our decision to classify independent LECs as non-dominant in the provision of in-region, interstate, domestic, interexchange services and to impose the Fifth Report and Order requirements, we will classify an independent LEC as non-dominant in the provision of in-region, international services, unless it is affiliated with a foreign carrier that has the ability to discriminate in favor of the independent LEC through control of bottleneck services or facilities in a foreign destination market.[531] We will apply section 63.10(a) of our rules to determine whether to regulate a independent LECs as dominant on those U.S. international routes where an affiliated foreign carrier has the ability to discriminate against unaffiliated U.S. international carriers through control of bottleneck services or facilities in the foreign destination market.[532] The safeguards that we apply to carriers that we classify as dominant based on a foreign carrier affiliation are contained in Section 63.10(c) of the our rules and are designed to address the incentive and ability of the foreign carrier to discriminate in favor of its U.S. affiliate in the provision of services or facilities necessary to terminate U.S. international traffic.[533] This framework for addressing issues raised by foreign carrier affiliations will apply to independent LECs' provision of U.S. international services as an additional component of our regulation of the U.S. international services market.

190. We reject MCI's suggestion that we should impose additional safeguards on

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[530] See supra ¶ 138.

[531] See supra ¶ 139.

[532] See Foreign Carrier Entry Order, 11 FCC Rcd 3873.

[533] As previously noted, section 63.10(a) of the Commission's rules provides that: (1) carriers having no affiliation with a foreign carrier in the destination market are presumptively non-dominant for that route; (2) carriers affiliated with a foreign carrier that is a monopoly in the destination market are presumptively dominant for that route; (3) carriers affiliated with a foreign carrier that is not a monopoly on that route receive closer scrutiny by the Commission; and (4) carriers that serve an affiliated destination market solely through the resale of an unaffiliated U.S. facilities-based carrier's switched services are presumptively nondominant for that route. See also Regulation of International Common Carrier Services, 7 FCC Rcd at 7334, ¶¶ 19-24.

the independent LEC's in-region, international services.[534] As we stated with regard to the BOCs, all U.S. international carriers are subject to the same prohibition against accepting "special concessions" from foreign carriers that we imposed on MCI in the Order approving BT's initial 20 percent investment in MCI.[535] The grooming described by MCI would constitute a special concession prohibited by the terms of Section 63.14 of the Commission's rules to the extent the U.S. carrier entered into a grooming arrangement that the foreign carrier did not offer to similarly situated U.S. carriers.[536] A U.S. carrier that negotiates a grooming arrangement with a foreign carrier on a particular route would be required to submit the arrangement to the Commission for public comment and review in circumstances where the arrangement deviates from existing arrangements with other U.S. carriers for the routing and/or settlement of traffic on that route.[537]

191. We believe our decision will benefit small incumbent LECs and small entities, for many of the same reasons enumerated in our analysis of independent LEC provision of in-region, interstate, domestic, interexchange services. For instance, by establishing a regulatory regime for provision of international services that is less stringent for incumbent independent LECs than for BOCs, independent LECs, some of which may be small incumbent LECs; will benefit by not being subjected to regulations that may be burdensome and may hamper competition in the international market. In addition, by limiting application of the Fifth Report and Order separations requirements to incumbent independent LECs, new entrants, some of which may be small entities, will benefit from lower market entry costs.

192. We decline to address whether MTC should be regulated as a dominant carrier for the provision of international services because of the inadequate record in this proceeding. We note that CNMI or any other petitioner may petition us to initiate a proceeding regarding MTC's regulatory status. We reiterate, however, our conclusion that all independent LECs that are providing international interexchange service through an affiliate that satisfies the Fifth Report and Order separation requirements as of the date of release of this Order must continue to do so, and all other independent LECs providing international interexchange service must comply with the Fifth Report and Order separation

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[534] See MCI Aug. 29, 1996 comments at 8 (citing MCI Aug. 15, 1996 Comments at 68-71).

[535] See supra ¶ 140.

[536] See 47 C.F.R. Section 63.14 ("[a]ny carrier authorized to provide international communications service . . . shall be prohibited from agreeing to accept special concessions directly or indirectly from any foreign carrier or administration with respect to traffic or revenue flows between the United States and any foreign country served . . . and from agreeing to enter into such agreements in the future. . . . ").

[537] See supra ¶ 140; see also ¶ 142.

requirements no later than one year from the date of release of this Order.[538]

5. Sunset of Separation Requirements for Independent LECs

a. Background

193. Section 272(f)(1) of the Communications Act provides that the BOC safeguards set out in section 272 shall sunset three years after the date that the BOC affiliate is authorized to provide interLATA telecommunications services, unless the Commission extends such three-year period by rule or order. In the NPRM we requested comment on whether any regulation of independent LECs should be subject to some type of sunset.

b. Comments

194. Frontier contends that we should eliminate any separation requirements applicable to independent LECs' provision of in-region, interstate, interexchange services no later than such time as section 272 requirements sunset.[539]

195. Excel and CNMI oppose the removal of the separate affiliate requirements applicable to independent LECs.[540] CNMI notes that the sunset provision in section 272 has no application to independent LECs. Moreover, CNMI states that in insular areas such as the Commonwealth, there is no evidence to suggest that effective local competition will develop in the near future.[541]

c. Discussion

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[538] The Commission's International Bureau recently granted GTE Hawaiian Tel.'s petition for reclassification as a non-dominant carrier in the Hawaiian market for international message telephone service (IMTS), subject to implementation by GTE Hawaiian Tel. of the Fifth Report and Order separation requirements which the Bureau imposed on an interim basis pending the outcome of this proceeding. Petition of GTE Hawaiian Telephone Company, Inc. for Reclassification as a Non-dominant IMTS Carrier, Order, DA 96-1748 (Int'l Bur. released Oct. 22, 1996). Our decision here does not modify the International Bureau's determination that GTE Hawaiian Tel. will remain a dominant IMTS carrier until it certifies to the Chief, International Bureau, that it is in compliance with the conditions of that Order. GTE Hawaiian Tel., must comply with the Fifth Report and Order separation requirements, however, within one year from January 1, 1997.

[539] Frontier Aug. 29, 1996 Comments at 10 & 12.

[540] Excel Aug. 15 Comments at 10; CNMI Aug. 15 Comments at 12.

[541] CNMI Aug. 15 Comments at 12.

196. We intend to commence a proceeding three years from the date of adoption of this Order to determine whether the emergence of competition in the local exchange and exchange access marketplace justifies removal of the Fifth Report and Order requirements.[542] We believe that three years should be a reasonable period of time in which to evaluate whether effective competition has developed sufficiently to reduce or eliminate an independent LEC's bottleneck control of exchange and exchange access facilities.

V. CLASSIFICATION OF BOCS AND INDEPENDENT LECS AS DOMINANT OR NON-DOMINANT IN THE PROVISION OF OUT-OF-REGION INTERSTATE, DOMESTIC, INTEREXCHANGE SERVICES

197. In this section, we consider whether the Competitive Carrier Fifth Report and Order separation requirements that were applied to the provision of out-of-region, interstate, domestic, interexchange services by independent LECs in the Competitive Carrier proceeding and to the provision of such services by the BOCs in the Interim BOC Out-of-Region Order are necessary as a condition for non-dominant regulatory treatment. As discussed below, we conclude that BOCs and independent LECs do not have and will not gain the ability in the near term to use their market power in the provision of local exchange service in their in-region markets to such an extent that the BOCs or independent LECs could profitably raise and sustain prices for out-of-region, interstate, domestic, interexchange services significantly above competitive levels by restricting their own output. We therefore classify the BOCs and independent LECs as non-dominant in the provision of these services. We also conclude that, at this time, a BOC or an independent LEC will not be able to raise significantly its interexchange rivals' costs by improperly allocating costs from its out-of-region interexchange services to its regulated exchange and exchange access services, unlawfully discriminating against its rivals, or engaging in a price squeeze in its provision of out-of-region, interstate, domestic, interexchange services. We therefore eliminate the separation requirements imposed in the Fifth Report and Order as a condition for non-dominant regulatory treatment of the BOCs and independent LECs in the provision of these out-of-region services.

A. Background

198. As previously noted, the Commission determined in the Competitive Carrier proceeding that interexchange carriers affiliated with independent LECs would be regulated as non-dominant carriers if they satisfied the three separation requirements identified in the

[542] See 47 U.S.C. § 272(f) (describing the sunsetting of section 272); see also Non-Accounting Safeguards Order at ¶¶ 268-271.

Competitive Carrier Fifth Report and Order.[543] The Commission further concluded that, if the LEC provided the interstate, interexchange services directly, rather than through an affiliate, those services would be subject to dominant carrier regulation.[544] Upon enactment of the 1996 Act, the BOCs were authorized to provide interLATA telecommunications services outside of their regions.[545] In the Interim BOC Out-of-Region Order, the Commission determined that, on an interim basis, the BOCs' out-of-region, interstate, domestic, interexchange services would be subject to the same regulatory treatment as the Commission applied to the independent LECs' interstate, domestic, interexchange services in the Fifth Report and Order.[546] In the Interexchange NPRM, the Commission sought comment on whether it should modify or eliminate the separation requirements that are currently imposed on independent LECs and BOCs, in order to qualify for non-dominant treatment in the provision of out-of-region interstate, interexchange services.[547]

B. Comments

199. The BOCs and independent LECs generally argue that they cannot exercise market power if they provide directly out-of-region, domestic, interstate, interexchange services.[548] Specifically, Ameritech asserts that the Commission may impose requirements as a condition of non-dominant treatment, such as a separate affiliate requirement, only if it can show that such a requirement is necessary to prevent the exercise of market power.[549] Ameritech further argues that the Commission cannot possibly show that a separate affiliate requirement is necessary to prevent the exercise of market power in out-of-region

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[543] See supra ¶ 144. The three requirements are that an affiliate: (1) maintain separate books of account; (2) not jointly own transmission or switching facilities with the LEC; and (3) acquire any services from its affiliated exchange company at tariffed rates, terms, and conditions. Competitive Carrier Fifth Report and Order, 98 FCC 2d at 1198, ¶ 9.

[544] Id.

[545] 47 U.S.C. § 271(b)(2).

[546] Interim BOC Out-of-Region Order at ¶¶ 15-25. In other words, a BOC would be subject to non-dominant treatment in the provision of out-of-region, interstate, domestic, interexchange services if it provided these services through a separate affiliate that satisfied the Fifth Report and Order separations requirements, but would be regulated as dominant if it provided these services directly. Id. at ¶¶ 19-25.

[547] Interexchange NPRM, 11 FCC Rcd at 7174, ¶ 61.

[548] See, e.g., Ameritech April 19, 1996 Comments at 5, May 3, 1996 Reply at 5-7; GTE May 3, 1996 Reply at 8.

[549] Ameritech May 3, 1996 Reply at 5 n.6.

interexchange services, and thus cannot link this requirement to non-dominant status.[550] SBC argues that neither independent LECs nor new-entrant BOCs have market power in the provision of out-of-region interexchange services based on the market power factors listed in AT&T Reclassification Order.[551] Furthermore, SNET asserts that the Competitive Carrier Fifth Report and Order separation requirements are not necessary for small independent LECs.[552] The Ohio Consumer Counsel argues, however, that rural carriers without a national presence should be subject to separation requirements if they receive suspensions or modification of section 251(b) or (c) of the 1996 Act.[553]

200. In addition, the BOCs and independent LECs generally claim that they no longer retain bottleneck control over exchange access services and that the Fifth Report and Order separation requirements are not necessary to prevent cross-subsidization and discrimination.[554] Ameritech notes that the Commission has found that a firm or group of firms has "bottleneck control" when it has sufficient command over some essential commodity or facility in its industry or trade to be able to impede new entrants.[555] Ameritech asserts that no BOC could impede long-distance entry because any such effort would be a blatant violation of equal access obligations and the Communications Act, and such an attempt would surely be discovered and punished.[556] Furthermore, several LECs argue that to the extent bottleneck control previously existed, the 1996 Act eliminates it by requiring interconnection and access to unbundled elements and resale, and by creating incentives for BOCs to implement these provisions in order to enter in-region long-distance.[557] Several BOCs further respond that they have neither the incentive nor the

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[550] Id.

[551] SBC April 19, 1996 Comments at 8-9.

[552] SNET April 19, 1996 Comments at 3.

[553] OCC May 3, 1996 Reply at 6.

[554] See, e.g., NYNEX April 19, 1996 Comments at 13, May 3, 1996 Reply at 7-14; U S West April 19, 1996 Comments at 10-11; Ameritech April 19, 1996 Comments at 3-10, May 3, 1996 Reply at 7-14; Bell Atlantic April 19, 1996 Comments at 3-5, May 3, 1996 Reply at 3-6; BellSouth April 19, 1996 Comments at 24; GTE April 19, 1996 Comments at 10-12, May 3, 1996 Reply at 8-13; SBC April 19, 1996 Comments at 6-7; SNET April 19, 1996 Comments at 9-16; USTA April 19, 1996 Comments at 8-12, May 3, 1996 Reply at 5-7. See also Florida PSC April 19, 1996 Comments at 11-12.

[555] Ameritech May 3, 1996 Reply at 8 (citing Competitive Carrier First Report and Order, 85 FCC 2d 1).

[556] Id.

[557] See, e.g., Ameritech May 3, 1996 Reply at 8; GTE May 3, 1996 Reply at 8-10.

opportunity to cross subsidize their long distance services.[558] NYNEX, BellSouth and GTE contend that separation requirements are unnecessary because the BOCs' rates for access services are subject to price caps.[559] NYNEX asserts that Commission's rules control the allocation of costs between interexchange and access services and require LECs to impute to their interexchange services the same access rates they charge to other carriers for in-region services.[560] Ameritech and Bell Atlantic argue that price caps (particularly without sharing) and cost allocation rules will prevent cross subsidization.[561] Bell Atlantic also contends that geographic separation between a BOC's local exchange operations and out-of-region long distance services eliminates the potential for cost shifting.[562]

201. Numerous non-LEC commenters, on the other hand, contend that the Commission should treat BOCs and independent LECs as non-dominant for out-of-region, interexchange services only so long as they satisfy the separation requirements in the Fifth Report and Order.[563] CompTel argues that the focal point of any decision to classify a BOC as dominant or non-dominant in interexchange services will not be the level of competition in the interexchange market, but the extent to which the BOC has lost its monopoly power in local exchange and exchange access services.[564] In addition, numerous commenters argue that the separation requirements are necessary to prevent cross-subsidization, unreasonable discrimination or other anticompetitive conduct.[565] Sprint contends that the Fifth Report and

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[558] See, e.g., NYNEX April 19, 1996 Comments at 13; BellSouth April 19, 1996 Comments at 24.

[559] See, e.g., NYNEX April 19, 1996 Comments at 13; BellSouth April 19, 1996 Comments at 24; GTE April 19, 1996 Comments at 10-11, May 3, 1996 Reply at 8.

[560] NYNEX April 19, 1996 Comments at 13.

[561] Ameritech April 19, 1996 Comments at 9-10, May 3, 1996 Reply at 14; Bell Atlantic April 19, 1996 Comments at 4.

[562] Bell Atlantic April 19, 1996 Comments at 3.

[563] See, e.g., MFS April 19, 1996 Comments at 8; Missouri Public Service Commission (MoPSC) April 19, 1996 Comments at 4; CompTel May 3, 1996 Reply at 6.

[564] CompTel May 3, 1996 Reply at 6. CompTel also contends that the Commission should treat the BOCs as dominant for out-of-region interexchange services unless the BOCs provide out-of-region services that are physically and administratively separate and the BOCs do not jointly market local and out-of-region services. Id.

[565] See, e.g., MoPSC April 19, 1996 Comments at 4; Vanguard Cellular Systems (Vanguard) April 19, 1996 Comments at 3-8; Alabama PSC April 19, 1996 Comments at 6-7; GSA April 19, 1996 Comments at 3-4; MCI April 19, 1996 Comments at 15-25, May 3, 1996 Reply at 7-13; CompTel May 3, 1996 Reply at 7; Sprint April 19, 1996 Comments at 8; TRA April 19, 1996 Comments at 7-9, May 6, 1996 Reply at 6-8; LDDS May

Order requirements are the most, and perhaps the only, reliable tool at hand for detecting and preventing cross-subsidization and discrimination.[566] The Missouri Commission claims that, unless LECs are required to maintain separate records for their LEC and IXC operations, it will be difficult, if not impossible, to determine whether any improper discrimination or cross subsidization has occurred.[567] The Alabama Commission asserts that the separation requirements ensure that carriers can compete on an equal basis in the interexchange market.[568] MCI argues that the continuing need for separate affiliate requirements is underscored by recent federal and state audits of BOC and LEC affiliate transactions, which uncovered improper cost allocations and demonstrated the ineffectiveness of the cost allocation regulations in preventing LEC cross-subsidies between regulated and unregulated services.[569]

202. In addition, several commenters claim that the BOCs and independent LECs have significant incentives to engage in improper cost allocation, discrimination, and other anti-competitive behavior, and are able to engage in such behavior due to their control of bottleneck facilities.[570] For example, MCI contends that the independent LECs' and BOCs' local bottleneck power can be exploited beyond their service areas by discriminating against an IXC dependent on the BOC or independent LEC for access in its region, thereby damaging the IXC's reputation on a national basis.[571] MCI further asserts that the similarity, and in some cases identity, of facilities used for monopoly and interexchange services would greatly aggravate the risks of cross-subsidization and discrimination on the terminating end of such calls.[572] Vanguard claims that, as suppliers of an essential input, BOCs are in a position to affect the cost structures of their competitors.[573] More specifically, Vanguard argues that any increase in charges for terminating traffic will raise the costs of non-affiliated

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3, 1996 Reply at 8-9; MFS May 3, 1996 Reply at 8-9; AT&T May 3, 1996 Reply at 15-18.

[566] Sprint April 19, 1996 Comments at 8-9.

[567] MoPSC April 19, 1996 Comments at 4.

[568] Alabama PSC April 19, 1996 Comments at 7.

[569] MCI April 19, 1996 Comments at 22-24.

[570] See, e.g., Vanguard April 19, 1996 Comments at 3; MCI April 19, 1996 Comments at 15-16; GSA April 19, 1996 Comments at 3.

[571] MCI April 19, 1996 Comments at 16.

[572] MCI April 19, 1996 Comments at 17.

[573] Vanguard April 19, 1996 Comments at 4.

interexchange providers that terminate calls over the same route. Vanguard notes that these increases must be absorbed by competitors, but will not injure the BOC because raising access charges to its affiliate will merely result in an intracompany transfer.[574] Commenters further contend that BOCs and independent LECs can discriminate in a variety of ways, such as slow service provisioning, delayed information about or roll-out of new technologies, less responsive maintenance and customer service, and poorer connections.[575] MCI asserts that LECs also can exploit information obtained in their capacity as local service providers to gain an advantage in out-of-region interexchange marketing, including such information as validation databases, and that they can manipulate the price or other terms and conditions of terminating traffic, including limiting access to certain signalling information.[576]

203. Several commenters contend that the cost and asset shifting techniques available to incumbent LECs are hard to detect and are not deterred by price caps.[577] MFS disputes BOC arguments that geographical separation between the BOCs' in-region exchange access and out-of-region interexchange facilities and price cap regulation moot concerns about cost shifting. MFS asserts that a BOC's ability to fund anticompetitive pricing schemes in the interexchange market from local exchange market profits is not impeded just because these markets are not contiguous or because the BOC performs artificial cost allocations. MFS argues that price cap mechanisms do not perfectly reflect actual cost changes and can yield windfall unintended profits for BOCs which could be used to subsidize interexchange services.[578] AT&T contends that the BOCs' assertions that price cap regulation removes exchange carriers' ability and incentive to allocate costs improperly ignores the fact that not all LECs have elected price caps, and those that have may periodically elect a "sharing" option.[579] MCI asserts that "pure" price caps do not deter cross subsidization because the conferring of monopoly-derived benefits upon a BOC's or independent LEC's interexchange operations at less than their economic value unfairly subsidizes those operations whether or not the BOC or LEC can raise its monopoly rates to

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[574] Id.

[575] See, e.g., MCI April 19, 1996 Comments at 18; CompTel May 3, 1996 Reply at 7.

[576] MCI April 19, 1996 Comments at 18-19.

[577] See, e.g., MCI April 19, 1996 Comments at 18; CompTel May 3, 1996 Reply at 7; TRA May 6, 1996 Reply at 9-10; MFS May 3, 1996 Reply at 8-9; AT&T May 3, 1996 Reply at 16-17.

[578] MFS May 3, 1996 Reply at 8-9.

[579] AT&T May 3, 1996 Reply at 16-17.

absorb additional costs.[580]

204. In addition, numerous commenters contend that even if the Fifth Report and Order separation requirements for independent LECs are modified or eliminated, the Commission should maintain these requirements as a condition for non-dominant treatment of the BOCs' provision of out-of-region, interexchange services.[581] Vanguard and GSA contend that the BOCs have greater opportunity to allocate costs improperly than the independent LECs because of their greater number of services, larger service territories, and more extensive interoffice facilities.[582] Vanguard notes, for example, that each BOC serves about one-eighth of all U.S. telephone subscribers in largely contiguous service territories, which means that the BOCs receive more calls than other LECs and have more opportunities to manipulate the price and quality of terminating access than other companies.[583] Vanguard argues that the proposed BOC mergers would further widen the size differentials between the BOCs and independent LECs.[584]

205. Several non-LECs contend that the Competitive Carrier Fifth Report and Order separation requirements are insufficient to protect against abuses by BOCs and independent LECs, and, therefore, propose additional safeguards. These commenters urge the Commission to: (1) impose full structural separation on the out-of-region affiliate;[585] (2) prohibit joint marketing of local and out-of-region, interexchange services;[586] (3) require that a LEC's out-of-region affiliate have no preferential access to non-Title II services offered by the LEC;[587] (4) require that the LEC's affiliate transaction practices and cost allocation

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[580] MCI May 3, 1996 Reply at 11.

[581] See, e.g., Office of the Ohio Consumer's Counsel (OCC) April 19, 1996 Comments at 3; Vanguard April 19, 1996 Comments at 5; Cable & Wireless April 19, 1996 Comments at 8; CompTel April 19, 1996 Comments at 3; LDDS April 19, 1996 Comments at 8-10.

[582] GSA April 19, 1996 Comments at 3-4; Vanguard April 19, 1996 Comments at 5.

[583] Vanguard April 19, 1996 Comments at 5.

[584] Id. at 5-6.

[585] See, e.g., CompTel April 19, 1996 Comments at 4; LDDS April 19, 1996 Comments at 10-11; TRA April 19, 1996 Comments at 22-23

[586] See, e.g., CompTel April 19, 1996 Comments at 4; LDDS April 19, 1996 Comments at 10-11; TRA April 19, 1996 Comments at 23-24.

[587] See, e.g., TRA April 19, 1996 Comments at 23-24; LDDS April 19, 1996 Comments at 10-11; Ohio PUC April 19, 1996 Comments at 4.

procedures be subject to annual independent audit;[588] and (5) prohibit the affiliate from receiving proprietary information unless it is made available to competitors on the same basis.[589]

C. Discussion

206. In Section IV, we concluded that a BOC affiliate or independent LEC should be classified as dominant in the provision of in-region, interstate, domestic, long distance services only if it has the ability to raise prices by restricting its output of those in-region services. We found that each of the traditional market factors (excluding bottleneck control) suggest that the BOC interLATA affiliates and independent LECs do not have the ability to raise the price of in-region, interstate, long distance services by restricting their output of these services.[590] We recognized that a BOC's or independent LEC's control of local exchange and exchange access facilities potentially gives the BOC or independent LEC an incentive to disadvantage its interexchange competitor through improper allocations of costs, discrimination or other anticompetitive conduct. We concluded, however, that the statutory and regulatory safeguards currently imposed on the BOCs and independent LECs will prevent them from engaging in such anticompetitive conduct to such an extent that the BOC interLATA affiliates or independent LECs have, or will have upon entry or shortly thereafter, the ability to raise the price of in-region, interstate, domestic, long distance services by restricting their output of these services. Accordingly, we classified the BOC interLATA affiliates and independent LECs as non-dominant in the provision of these in-region services.

207. We conclude that we should apply a similar analysis in assessing whether to classify the BOCs and independent LECs as dominant in the provision of out-of-region, interstate, domestic, interexchange services. We conclude that the traditional market power factors (excluding bottleneck facilities) -- market share, supply and demand substitutability, cost structure, size, and resources -- support a finding that the BOCs and independent LECs do not have, and will not gain the ability in the near term, to raise prices of out-of-region interexchange services by restricting their output of these services. More specifically, we find, first, that the BOCs begin with an interexchange market share of zero while the market shares of the independent LECs are negligible when compared to the major interexchange carriers. Second, we find that the same high supply and demand elasticities that the Commission found constrained AT&T's price behavior also apply to the provision of out-of-region interexchange services by the BOCs and independent LECs. Finally, we find that the

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588 See, e.g., LDDS April 19, 1996 Comments at 11.

589 See, e.g., Ohio PUC April 19, 1996 Comments at 4; TRA April 19, 1996 Comments at 22-24.

590 See supra ¶¶ 96, 157.

presence of existing interexchange carriers, including AT&T, MCI, Sprint, and LDDS, prevents the BOCs and independent LECs from using their cost structure, size, and resources to raise prices above the competitive level for their out-of-region interstate, domestic, interexchange services.

208. With respect to discrimination concerns related to the provision of out-of-region, interstate, interexchange services by the BOCs and independent LECs, we note that these carriers are not the dominant providers of originating exchange access services in out-of-region areas. We also note that majority of the discrimination concerns raised by commenters focus on inferior interconnection to a LEC's network for originating exchange access. We therefore find that the BOCs' and independent LECs' lack of control over originating access for its competitors' calls originating outside its region significantly limits their ability to discriminate against their interexchange competitors and to engage in other anticompetitive conduct. Although it is possible that a LEC could damage an interexchange competitor's reputation on a national basis by discriminating against an interexchange carrier dependent on it for access in its region, we believe this is unlikely because the BOCs and independent LECs are subject to our equal access requirements.[591] In addition, as discussed in Section IV, we believe that the safeguards in place for the provision of in-region, interstate, interexchange services by BOCs and independent LECs further protect against originating exchange access discrimination.[592] We therefore conclude that our equal access provisions and safeguards established for in-region interstate, interexchange services provide sufficient protection to interexchange carriers for the provision of originating exchange access as well as for the quality of these services. Similarly, although a BOC or an independent LEC may control the facilities used to terminate its interexchange competitors calls in its in-region service area, we believe it has less opportunity to discriminate against competitors through its control of these facilities. In order to discriminate effectively through control of terminating exchange access, the BOCs and independent LECs would have to convince consumers that an inferior termination connection was the fault of their interexchange carrier, and that the only way to obtain efficient termination arrangements to this region would be through the BOCs' or independent LECs' interexchange services. In addition, to the extent such quality degradation is apparent to consumers, it is also likely to be apparent to regulators and interexchange competitors. We also note that the record in the Interexchange proceeding does not demonstrate that the BOCs and LECs have the technical ability to

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[591] See United States v. Western Elec. Co., 552 F. Supp. at 232-33 (subsequent history omitted); United States v. GTE Corporation, 603 F. Supp. 730, 744 (D.D.C. 1984) (subsequent history omitted); MTS and WATS Market Structure, CC Docket No. 78-72, Phase III, 100 FCC 2d 860 (1985), recon. denied, FCC 86-4, 59 Rad. Reg. 2d 1410 (rel. Jan. 4, 1986). See also 47 U.S.C. § 251(g) (preserving the equal access requirements and nondiscrimination requirements that applied to local exchange carriers on the date of enactment, until such requirements are explicitly superseded by the Commission's regulations).

[592] See supra ¶ 91, 163.

degrade selectively the quality of the interconnection for their interexchange competitors through their control of terminating exchange access. In addition, Section 222 of the Communications Act provides all telecommunications carriers with protection from the misuse of customer proprietary network information.[593] We, therefore, conclude that discrimination by a BOC or an independent LEC is unlikely in the context of out-of-region, interstate, interexchange services.

209. In addition, we agree with Bell Atlantic that the geographic separation between a LEC's in-region local exchange and exchange access operations and out-of-region long distance operations mitigates the potential for undetected improper allocation of costs.[594] Because of this geographic separation, it is unlikely that the out-of-region operation will be able to share any transmission or switching facilities, many employees, or other common costs with the in-region operation. Consequently, improper allocation of costs is less problematic with respect to a BOC's or independent LEC's provision of out-of-region long distance services. We further conclude that statutory and regulatory safeguards, including our Part 64 rules, imposed on the BOCs and independent LECs sufficiently limit any residual ability to disadvantage their rivals by improperly allocating costs between their regulated local exchange and exchange access services and their out-of-region interexchange services.[595] Our cost allocation rules control the allocation of cost between interexchange and local services and require a BOC or an independent LEC to impute to its interexchange services the same access rates it charges other carriers.[596] Furthermore, in the Accounting Safeguards Order, the Commission determined, solely for federal accounting purposes, that out-of-region interLATA services provided by incumbent LECs on an integrated basis should be treated like nonregulated activities for purposes of our cost allocation rules.[597] We find that the existing statutory and regulatory safeguards, coupled with the geographical separation between the BOCs' and LECs' in-region and out-of-region operations, are sufficient to prevent the BOCs and independent LECs from improperly allocating costs.[598] Furthermore, we note that the exchange access services for all of the BOCs and most of the largest independent LECs are subject to our price cap regulations. As discussed in Section IV, price

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[593] See 47 U.S.C. § 222.

[594] Bell Atlantic April 19, 1996 Comments at 3.

[595] See supra ¶¶ 104, 163.

[596] See 47 C.F.R. § 64.901(b)(1).

[597] Accounting Safeguards Order at ¶ 75.

[598] We therefore disagree with MFS' assertion that a LEC's ability to fund anticompetitive pricing schemes in the interexchange market from local exchange market profits exists even thought these markets are not contiguous or because the BOC performs artificial cost allocations.

cap regulation further serves to reduce the potential that the BOCs and independent LECs will improperly allocate the costs of their interexchange services.[599] Consequently, we conclude that the risk that the BOCs and independent LECs would be able to allocate improperly substantial costs from their out-of-region interLATA services to their monopoly local exchange and exchange access services is not sufficient to warrant imposing separation requirements.

210. We also conclude that the BOCs and independent LECs will not be able to engage in a price squeeze with respect to their out-of-region, interstate, domestic, interexchange services to such an extent that they will gain the ability to raise prices of long distance services by restricting their output of those services. We are not persuaded by arguments that, because BOCs and independent LECs have control over terminating exchange access, they will be able to effect a price squeeze to gain market share by raising the price of terminating access. We note that, because the BOCs and independent LECs do not have control over originating exchange access for out-of-region, interstate, interexchange services, they will incur the same cost for originating access as their interexchange competitors. In addition, to the extent that a BOC or independent LEC offers out-of-region long distance services on an integrated basis, our rules require the carrier to impute to itself its tariffed terminating exchange access rate.[600] If a BOC or independent LEC offers out-of-region long distance services through an affiliate, the affiliate will have to pay the tariffed exchange access rate for long distance calls it terminates on the BOC's or independent LEC's in-region network.[601] Also, price cap regulation of exchange access services mitigates the ability of a BOC or independent LEC to effect a price squeeze by increasing terminating exchange access rates.[602] Moreover, we believe an attempted price squeeze would be less

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[599] See supra ¶ 106.

[600] Under section 64.901(b)(1) of our rules, tariffed services, such as exchange access services, provided to a nonregulated activity must be charged to the nonregulated activity at the tariffed rates and credited to the regulated revenue account for that service. 47 C.F.R. § 64.901(b)(1). See also 47 C.F.R. § 32.5280 (explaining how carriers must account for the provision of tariffed services to nonregulated activities). As previously noted, out-of-region interLATA services provided by incumbent LECs on an integrated basis are treated as nonregulated activities for federal accounting purposes. Accounting Safeguards Order at ¶ 75.

[601] We also note that section 272(e)(3) of the Communications Act requires a BOC to "charge [its section 272 interLATA affiliate], or impute to itself (if using the access for its provision of its own services), an amount for access to its telephone exchange service and exchange access that is no less than the amount charged to any unaffiliated interexchange carriers for such service." 47 U.S.C. § 272(e)(3). See also Non-Accounting Safeguards Order at ¶¶ 256-58 (implementing section 272(e)(3)).

[602] All BOCs and most of the largest independent LECs are subject to price cap regulation. 1996 Annual Access Tariff Filings, DA 96-1022, ¶ 2 n.2 (rel. June 24, 1996). All but one BOC is subject to price caps without sharing. Data based on 1996 Annual Access Tariff Filings filed on April 2, 1996.

likely to be effective, because it appears that typically a BOC's originating out-of-region calls that terminate in-region will account for a small percentage of the BOC's total out-of-region originating traffic.[603] Finally, we note that there are other adequate mechanisms to address such behavior. More specifically, a BOC or an independent LEC that charges a rate for interstate services below its incremental costs of providing service in the long term would be in violation of sections 201 and 202 of the Act.[604] In addition, Federal antitrust law also would apply to the predatory pricing of interstate services.

211. Based on the foregoing, we conclude that the BOCs and independent LECs do not have, upon entry or soon thereafter, the ability to raise the price of out-of-region, interstate, interexchange services by restricting their own output even if they are permitted to provide these services on an integrated basis. We therefore conclude that it is not necessary to require the BOCs or independent LECs to maintain the Competitive Carrier Fifth Report and Order separation requirements as a condition for non-dominant regulatory treatment for the provision of out-of-region, interstate, interexchange services.[605] Upon the effective date of this Order, the requirements established herein for the provision of out-of-region, interstate, interexchange services by BOCs will supersede any conflicting requirements established in the Interim BOC Out-Of-Region Order.

212. Contrary to the comments of GSA and Vanguard,[606] we find that the record in this proceeding does not demonstrate that a BOC is in a better position than an independent LEC to leverage its in-region monopoly power arising from its control of the local exchange to benefit its provision of out-of-region long distance services. We therefore conclude that there is no persuasive reason to implement different regulatory schemes for the BOCs and independent LECs in the context of their provision of out-of-region long distance services.

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[603] We acknowledge, however, that some BOCs and independent LECs may market their out-of-region interexchange services to customers who routinely terminate in the BOC's or independent LEC's in-region local exchange and exchange access area. See, e.g., AT&T Sept. 13 Reply, Appendix B.

[604] Non-Accounting Safeguards Order at ¶ 258. See also AT&T Communications Tariff F.C.C. No. 1; PRO America Optional Calling Plan; Alascom, Inc. Tariff F.C.C. No. 1; Block-of-Time Call America, Memorandum Opinion and Order, 103 FCC 2d 134, 136, ¶ 3 (1985).

[605] We note, however, that because BOCs and independent LECs are required to offer in-region, interstate, interexchange services through a separate affiliate, some may provide their out-of-region, interstate, interexchange services through the same affiliate rather than directly. We further note that, in the Accounting Safeguards Order, the Commission determined that affiliate transactions rules apply to all transactions between incumbent local exchange carriers and their affiliates providing any of the competitive services of the types permitted under sections 260 and 271 through 276. Accounting Safeguards Order at ¶ 256.

[606] GSA April 19, 1996 Comments at 3-4; Vanguard April 19, 1996 Comments at 5.

213. We also conclude that the Fifth Report and Order separation requirements and the additional safeguards suggested in the record,[607] are not necessary to prevent the BOCs and independent LECs from raising the costs of their interexchange rivals' services originating outside the BOC's or independent LEC's region. As discussed above, we believe that other applicable safeguards, coupled with the geographic separation between the BOCs' and independent LECs' in-region and out-of-region operations will prevent a BOC or independent LEC from favoring its out-of-region interexchange services through improper allocation of costs, discrimination, or other anticompetitive conduct. Further, we found in the Interim BOC Out-of-Region Order that the commenters presented no persuasive evidence that showed additional safeguards were warranted to prevent improper allocation of costs and discrimination.[608] In Section IV.B., we found that no party presented persuasive evidence in this proceeding that shows that it is necessary to impose additional safeguards on the independent LECs as a condition for non-dominant regulatory treatment for the provision of in-region, interstate, interexchange service.[609] Consequently, we conclude that the Fifth Report and Order separation requirements and the proposed additional safeguards are unnecessary in this context, and should therefore be eliminated.[610]

VI. FINAL REGULATORY FLEXIBILITY ANALYSIS

214. As required by Section 603 of the Regulatory Flexibility Act (RFA), 5 U.S.C. § 603, an Initial Regulatory Flexibility Analysis (IRFA) was incorporated in each of the two Notices of Proposed Rulemaking from which this Order issues.[611] The Commission sought written public comment on the proposals in the Notices. The Commission's Final Regulatory Flexibility Analysis (FRFA) in this Order conforms to the RFA, as amended by the Contract With America Advancement Act of 1996 (CWAAA).[612]

A. Need for and Objectives of this Report and Order and the Regulations

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[607] See, e.g., CompTel April 19, 1996 Comments at 4; LDDS April 19, 1996 Comments at 10-11; TRA April 19, 1996 Comments at 22-24; Ohio PUC April 19, 1996 Comments at 4.

[608] BOC Out-of-Region Interim Order at ¶ 19.

[609] See supra ¶ 170.

[610] With respect to small independent LECs, we note that this decision may promote their expansion into new telecommunications services and information services consistent with section 257 of the Act. See 47 U.S.C. § 257.

[611] Interexchange NPRM at 7192-93, ¶¶ 103-111; Non-Accounting Safeguards NPRM at ¶ 165.

[612] Pub. L. No. 104-121, 110 Stat. 847 (1996). Title II of the CWAAA is "The Small Business Regulatory Enforcement Fairness Act of 1996," codified at 5 U.S.C. § 601 et seq.

Adopted Herein

215. In the 1996 Act, Congress sought to establish "a pro-competitive, de-regulatory national policy framework" for the United States telecommunications industry.[613] Three principal goals of the telephony provisions of the 1996 Act are: (1) opening local exchange and exchange access markets to competition; (2) promoting increased competition in telecommunications markets that are already open to competition, particularly long distance services markets; and (3) reforming our system of universal service so that universal service is preserved and advanced as local exchange and exchange access markets move from monopoly to competition.

216. The regulations adopted in this Order implement the second of these goals -- promoting increased competition in the interexchange market. The objective of the regulations adopted in this Order is to implement as quickly and effectively as possible the national telecommunications policies embodied in the 1996 Act and to promote the development of competitive, deregulated markets envisioned by Congress.[614] In doing so, we are mindful of the balance that Congress struck between this goal of bringing the benefits of competition to all consumers and its concern for the impact of the 1996 Act on small incumbent local exchange carriers.

B. Analysis of Significant Issues Raised in Response to the IRFA

217. As noted above, this Order issues from two separate Notices of Proposed Rulemaking. In March 1996, the Commission released a Notice asking, among other things, whether we should modify or eliminate the separation requirements imposed on independent LECs as a condition for non-dominant treatment of their out-of-region, interstate, domestic, interexchange services.[615] In July 1996, we released a Notice seeking comment on, in addition to other issues, whether to modify our existing regulations governing independent LECs' provision of in-region, interstate, domestic, interexchange services, and whether to apply the same regulatory treatment to their provision of in-region, international services.[616]

218. *Summary of the Initial Regulatory Flexibility Analyses (IRFAs).* In each of the Notices, the Commission performed an IRFA. In the IRFA for the Interexchange NPRM,

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[613] S. Conf. Rep. No. 230, 104th Cong., 2d Sess. 1 (1996).

[614] Id.

[615] Interexchange NPRM at 7174, ¶ 61.

[616] Non-Accounting Safeguards NPRM at ¶ 142.

the Commission did not find that any of the issues that are addressed in this Order would have a significant economic impact on a substantial number of small businesses as defined by section 601(3) of the RFA. In the IRFA for the Non-Accounting Safeguards NPRM, the Commission certified that its proposed regulations would not, if promulgated, have a significant economic impact on a substantial number of small businesses as defined by section 601(3) of the RFA.[617] We stated that our regulatory flexibility analysis was inapplicable to BOCs and other incumbent LECs because these entities are dominant in their field of operation.

1. Treatment of Small LECs

219. *Comments.* NTCA claims that its membership includes companies that constitute "small business concerns" under the RFA.[618] NTCA argues that our IRFA in the Non-Accounting Safeguards NPRM incorrectly certifies that our proposed regulations will not have a significant economic impact on a substantial number of small entities.[619] NTCA states that the Small Business Administration (SBA) establishes size standards for small businesses that "seek to ensure that a concern that meets a specific size standard is not dominant in its field of operation."[620] NTCA states that the Commission cannot ignore SBA definitions and conclude that all incumbent LECs are dominant for purposes of the Regulatory Flexibility Analysis.[621] NTCA recommends that we "consider flexible regulatory proposals and analyze any significant alternatives that would minimize significant economic impacts" of our regulations on its members that are small companies.[622]

220. *Discussion.* NTCA essentially argues that we exceeded our authority under the RFA by certifying all incumbent LECs as dominant in their field of operation, and concluding on that basis that they are not small businesses under the RFA. We have found incumbent LECs to be "dominant in their field of operation" since the early 1980s, and we consistently have certified under the RFA that incumbent LECs are not subject to regulatory

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[617] Id. at ¶ 65.

[618] NTCA Aug. 29, 1996 Comments at 5.

[619] Id.

[620] Id. at 6 (citing 13 C.F.R. § 121.102(b)).

[621] Id. at 6.

[622] Id. at 5.